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Dairy and Products

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Report Highlights:

Argentine milk production and dairy exports in 2006 are forecast at a record high. Good prices at the farm and processing level, as result of a firm domestic and foreign demand, will result in good profitability. The structural changes in the world dairy market are encouraging local processors to be very optimistic about their future. Production is expected to expand 4-5 percent annually in the next few years and will more than offset a higher domestic demand. Growing exports will focus on whole dry milk and cheese.

Includes PSD Changes: Yes
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Annual Report
Buenos Aires [AR1]
[AR]

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SECTION I. SITUATION AND OUTLOOK

Argentine dairy exports are forecast to reach record levels in 2006. This is a result of an ongoing recovery in production since 2003, strong international demand and expected high world prices. Domestic demand is also expected to grow but not commensurate with external demand, leaving somewhat larger milk surplus for exports. Most players in the local dairy sector see a very promising future of their industry, since they believe that profound structural changes are occurring in the international market. The fact that the European Union (EU) will produce less milk in the future and consumption in Asia is expected to grow are opening up excellent opportunities for countries like Argentina, which has the natural resources for dairy production at very competitive costs. Local dairy exports currently penetrate over 100 different markets.

Shipments of whole dry milk in 2006, the number one export product from Argentina, are forecast at 190,000 tons, the highest ever. Returns in whole dry milk have been very good. Most current and near future local investment is geared towards this product, in which drying capacity is growing at a steady rate. Argentine exporters also have the flexibility of producing custom made products to meet customers' needs. A good portion of the whole dry milk that is exported has added nutrients (iron, vitamins, etc.), and the packaging comes in diverse sizes and styles. For 2006, the main markets are expected to be primarily petroleum producing countries (like Algeria, Venezuela, Nigeria, México), which are enjoying incredibly high income through their oil exports. Other markets of importance will be Brazil, and the recently opened markets of Vietnam and Cuba. Local traders forecast 2006 FOB prices to range between US\$2,100-2,250 per ton, slightly lower than those of 2005.

Cheese exports in 2006 are projected at 65,000 tons, the highest ever. Argentina has always been a very important cheese manufacturing country, focused primarily on its domestic market. However, many are looking to export cheese due to strong world prices, and less punitive export taxes vis-à-vis dry milk exports. Not only large processors are exporting, but also medium cheese manufacturers are getting started in the business. These latter usually do not have drying capacity (although some dry milk in third plants and pay about US\$300 per ton for the service). Exporting cheese is a rapid and easy way to expand their businesses. Local cheese exporters see a very promising future, especially given the fast growing popularity of pizza consumption around the world. Asia, Middle East, The Russian Federation and Mexico present excellent future opportunities, primarily for soft and semi-soft cheese. Major markets for 2006 are expected to be the U.S. which provides Argentina a tariff rate quota of 6,800 tons (although exports outside the quota, paying roughly 20 percent duty, are growing) which in the main, absorbs hard cheese, while Russia, Mexico, and Chile primarily buy semi-soft cheese.

Non fat dry milk exports in 2006 are forecast at 22,000 tons, similar to the previous year. The main markets are expected to be Brazil, Mexico, Chile, and South Africa. The exportation of other dairy products is also expected to continue in the rise. During the first eight months of 2005, exports of UHT milk, milk proteins, whey, butterfat, milk caramel (dulce de leche), lactose, yogurt and desserts totaled 33,000 tons, 32 percent higher than the same period last year. The main markets for these products are Brazil, Chile and Uruguay.

Imports of dairy products are negligible. After the devaluation in 2002, imports became very expensive. Until then, Argentina imported some dairy ingredients (whey, proteins) and specialty cheeses, and occasionally, fluid milk in bulk from Uruguay. Argentina is increasing its capacity to produce dairy proteins and ingredients. Cheese imports are expected to

increase in 2006 (although still low) as the purchasing power increases. A large portion is processed cheese coming from Brazil for the fast food sector. A few years ago, this type of cheese, as well as cream cheese, was sourced from the U.S., but now both types are manufactured and imported from Brazil. Purchases of fluid milk from neighbor Uruguay are forecast to remain very small, as farmgate prices in dollar terms are not very attractive. Some dry milk could be imported in 2006, but it is primarily inter-company trade.

The following table shows current import duties, export taxes and export rebates on dairy products (in %):

Product	Import Duty	Export Rebate	Export Tax
Fluid Milk (UHT)	14.0	3.4	15.0
Whole Dry Milk (<2 Kg)	16.0	6.0	15.0
Whole Dry Milk (>2 Kg)	16.0	3.4	15.0
Nonfat Dry Milk (<2 Kg)	16.0	6.0	15.0
Nonfat Dry Milk (>2 Kg)	16.0	3.4	15.0
Soft Cheese (<5 Kg)	16.0	6.0	10.0
Hard Cheese (>8 Kg)	16.0	4.5	10.0

Production of milk in 2006 is forecast at 10.3 billion liter, reaching the previous record output of 1999. This is a result of very good profitability at the farm level, based on high farmgate milk prices and low production costs (especially for feed). Relatively good returns in the export and domestic markets are making processors increase their capacity and thus compete aggressively for the purchase of milk at the farm. Although post does not expect many new dairies to open (in fact the number continues to decline gradually), most farmers are improving animal nutrition and management. Based on current favorable prices of replacement heifers, which are not easy to find, many farmers are expanding gradually their herds. In cases of producers of both cattle and cropping, some are taking away resources (land and feed) from their beef cattle and crop area and diverting them to dairy production. There have been a few announcements of the construction of new large dairies. It is doubtful that dairy farmers who are already in the business will build new operations since land values are extremely high. They will probably consolidate what they have to reduce risk.

Private sources indicate that the current cost of production (not including land costs) for a liter of milk is roughly between US\$0.12-0.13, while farmgate price is about US\$0.17-0.18. No big change is expected in 2006, except for certain increases in production costs.

In early 2005, the Government of Argentina (GOA) signed price agreements with the dairy, beef, and poultry sectors in order to attempt to control growing inflation. Prices of most products were frozen for several months and most agreements were to be revised a few months later. In mid 2005, the dairy sector advised the GOA that it could no longer honor this agreement, since production costs - especially farmgate milk prices - under girded by strong export demand, had increased and they needed to raise the price of products in the domestic market. The GOA then asked the sector to come up with a solution. Due to the lack of agreement within the industry, the GOA, in late July, decided to increase export taxes on dry milk from 5 percent to 15 percent and cheese from 5 percent to 10 percent. These increased export taxes are to be in place for a 180 day period, after which, the GOA will review the impact of this policy measure. The GOA hopes that this measure will result in fewer exports and greater domestic supply. Most sources indicate that farmgate milk prices have not come down because of this measure. There is great uncertainty what the GOA will do in January 2006 when it reviews this measure. In general, most people are inclined to

believe that increased export taxes will continue for some more time as the GOA continues to state that it will continue to implement price controls to address inflation.

Domestic milk consumption for 2006 is forecast to increase marginally. A growing economy, salary increases and a growing milk supply are expected to prop up consumption, especially that of cheese and fluid milk. However, strong export demand will affect domestic supply. Private sources indicate that per capita consumption (in milk equivalent) is close to 200 liters, which is high compared to most countries, but still lower than the record of 231 liters in 2000. However, that level was reached at a time when dairy exports were unprofitable, and thus, processors preferred to inject more product into the domestic market. Of the 2006 milk output, roughly 75 percent of it will be consumed domestically, while the balance will be exported.

Investment in the sector is expected to continue in the near future. At the farm level, dairy farmers are improving animal genetics and feed equipment, and are sowing new pastures. They are also using larger quantities of fertilizers, are modernizing cooling tanks (most farmers are producing larger volumes), and are upgrading milking equipment. At the processing level, most investment is geared towards expanding the capacity for dry milk production (based on private estimations, the country's real effective drying capacity in 2004 was roughly 10 million liters a day, and is expected to expand to 13 million liters a day in 2006). There is also investment in cheese processing, especially for the export market, and the production of dry dairy protein products. Most sources believe that in the near future the multinational dairy companies already present in the market will take over some of the large or medium-large local dairy companies. However, some contacts indicate that investment has decelerated after the additional export taxes were imposed.

Although there are no official numbers, sources estimate that there are between 12-13,000 dairy operations in Argentina. Over 95 percent of the dairy herd is composed of Holstein cows, while the balance are Jerseys and some other minor breeds. Local dairies typically base their feeding on pastures (primarily alfalfa), corn silage and corn. Some soy or sunflower concentrates are being added. The average milk produced has about 3.53 percent butterfat, 3.23 percent of protein, and has a low bacteria and somatic cell count.

The GOA has indicated that it wants to maintain the current exchange rate through 2006 in order to continue to be competitive in world markets, and to boost exports. Several local economists predict the value of the dollar at 3 pesos and inflation at about 10 percent for 2006. Increased inflation should erode some competitiveness of the export sector.

The GOA does not have a specific policy focused on the dairy sector. Apart from controlling domestic prices and setting export taxes, the GOA is working with the sector to create independent milk quality laboratories and a referential farmgate milk price. Export taxes were implemented in 2002 for many products. The GOA set the level at 5 percent for dairy products. With the money collected by the recent tax increase (estimated at US\$ 20 million), the GOA has indicated that it will offer the sector subsidized interest rates to purchase dairy equipment. This is a new modality by which the government is offering to support a sector which is taxed. Although still not in operation, some sources doubt the effectiveness of this proposed mechanism due to the small amount of credit per producer.

Although there is no official or private entity specifically aimed at promoting Argentine dairy products throughout the world, the Ministry of Foreign Relations has a foundation destined to promote products in general. The promotion of food products is one of its priorities, and participates in most international large food shows. Many local dairy exporters participate or have participated in international food shows under the auspice of this foundation.

SECTION II. STATISTICAL TABLES

PSD Table

Country Commodity	Argentina Dairy, Milk, Fluid					
	(1000 HEAD)			(1000 M)		
	2004	Revised	2005	Estimate	2006	Forecast
	USDA Official [	Estimate[1]	USDA Official [	Estimate[1]	USDA Official [	Estimate[1]
Market Year Begin	01/2004		01/2005		01/2006	
Cows In Milk	2000	2000	2100	2100	0	2150
Cows Milk Production	8750	9250	9375	9850	0	10300
Other Milk Production	0	0	0	0	0	0
TOTAL Production	8750	9250	9375	9850	0	10300
Intra EC Imports	0	0	0	0	0	0
Total Imports	40	37	30	4	0	5
TOTAL Imports	40	37	30	4	0	5
TOTAL SUPPLY	8790	9287	9405	9854	0	10305
Intra EC Exports	0	0	0	0	0	0
Total Exports	12	8	14	10	0	10
TOTAL Exports	12	8	14	10	0	10
Fluid Use Dom. Consum.	2150	1800	2200	1900	0	2000
Factory Use Consum.	6628	7479	7191	7944	0	8295
Feed Use Dom. Consum.	0	0	0	0	0	0
TOTAL Dom. Consumptic	8778	9279	9391	9844	0	10295
TOTAL DISTRIBUTION	8790	9287	9405	9854	0	10305
Calendar Yr. Imp. from U.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0

PSD Table

Country Commodity	Argentina Dairy, Cheese					
	(1000 MT)					
	2004	Revised	2005	Estimate	2006	Forecast
	USDA Official [	Estimate[1]	USDA Official [	Estimate[1]	USDA Official [	Estimate[1]
Market Year Begin	01/2004		01/2005		01/2006	
Beginning Stocks	22	22	30	23	31	30
Production	345	370	360	400	0	425
Intra EC Imports	0	0	0	0	0	0
Total Imports	1	0	1	2	0	4
TOTAL Imports	1	0	1	2	0	4
TOTAL SUPPLY	368	392	391	425	31	459
Intra EC Exports	0	0	0	0	0	0
Total Exports	28	31	30	45	0	65
TOTAL Exports	28	31	30	45	0	65
Human Dom. Consumpti	310	338	330	350	0	360
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	310	338	330	350	0	360
TOTAL Use	338	369	360	395	0	425
Ending Stocks	30	23	31	30	0	34
TOTAL DISTRIBUTION	368	392	391	425	0	459
Calendar Yr. Imp. from U.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0

PSD Table

Country	Argentina					
Commodity	Dairy, Dry Whole Milk Powder (1000 MT)					
	2004	Revised	2005	Estimate	2006	Forecast
	USDA Official [	Estimate[1]	USDA Official [	Estimate[1]	USDA Official [	Estimate[1]
Market Year Begin	01/2004		01/2005		01/2006	
Beginning Stocks	27	27	28	25	29	24
Production	220	260	260	270	0	270
Intra EC Imports	0	0	0	0	0	0
Total Imports	1	1	1	4	0	5
TOTAL Imports	1	1	1	4	0	5
TOTAL SUPPLY	248	288	289	299	29	299
Intra EC Exports	0	0	0	0	0	0
Total Exports	125	177	160	185	0	190
TOTAL Exports	125	177	160	185	0	190
Human Dom. Consumpti	95	86	100	90	0	90
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	95	86	100	90	0	90
TOTAL Use	220	263	260	275	0	280
Ending Stocks	28	25	29	24	0	19
TOTAL DISTRIBUTION	248	288	289	299	0	299
Calendar Yr. Imp. from U.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0

PSD Table

Country Commodity	Argentina Dairy, Milk, Nonfat Dry (1000 MT)					
	2004 USDA Official [	Revised Estimate[1]	2005 USDA Official [	Estimate[1]	2006 USDA Official [	Forecast Estimate[1]
Market Year Begin	01/2004		01/2005		01/2006	
Beginning Stocks	6	6	5	4	6	2
Production	35	35	40	40	0	42
Intra EC Imports	0	0	0	0	0	0
Total Imports	0	0	0	0	0	0
TOTAL Imports	0	0	0	0	0	0
TOTAL SUPPLY	41	41	45	44	6	44
Intra EC Exports	0	0	0	0	0	0
Total Exports	16	18	18	22	0	22
TOTAL Exports	16	18	18	22	0	22
Human Dom. Consumpti	20	19	21	20	0	20
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	20	19	21	20	0	20
TOTAL Use	36	37	39	42	0	42
Ending Stocks	5	4	6	2	0	2
TOTAL DISTRIBUTION	41	41	45	44	0	44
Calendar Yr. Imp. from U.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0